

Audit



Report

OFFICE OF THE INSPECTOR GENERAL

**OVERDISBURSED AND UNRECONCILED DOD
CONTRACTS AT THE DEFENSE FINANCE AND
ACCOUNTING SERVICE COLUMBUS CENTER**

Report No. 96-141

June 4, 1996

Department of Defense

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Acronyms

DFAS
MOCAS

Defense Finance and Accounting Service
Mechanization of Contract Administration Services



INSPECTOR GENERAL
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June 4, 1996

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER)
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING
SERVICE

SUBJECT: Audit Report on Overdisbursed and Unreconciled DoD Contracts at the
Defense Finance and Accounting Service Columbus Center
(Report No. 96-141)

We are providing this audit report for review and comments. Management comments on a draft of this report were considered in preparing the final report.

DoD Directive 7650.3 requires that all recommendations be resolved promptly. The Under Secretary of Defense (Comptroller) nonconcurred with Recommendation B.1. We request that the Under Secretary of Defense (Comptroller) provide comments on the unresolved recommendation by August 5, 1996.

We appreciate the courtesies extended to the audit staff. Questions on the audit should be directed to Mr. James L. Kornides, Audit Program Director, or Mr. Barry N. Harle, Acting Audit Project Manager, at (614) 751-1400. See Appendix G for the report distribution. Audit team members are listed inside the back cover.

Robert J. Lieberman
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Office of the Inspector General, Department of Defense

Report No. 96-141
(Project No. 5FJ-5011)

June 4, 1996

Overdisbursed and Unreconciled DoD Contracts at the Defense Finance and Accounting Service Columbus Center

Executive Summary

Introduction. The Defense Finance and Accounting Service (DFAS) Columbus Center, Columbus, Ohio, annually receives about 1.2 million contractor invoices valued at \$60 billion, and processes those invoices for payment through its Mechanization of Contract Administration Services system. If the disbursements recorded for the invoices do not agree with the obligations recorded on the contracts, the two amounts must be reconciled. Reconciliation ensures that fund balances are accurate, disbursements are matched to obligations, and contractors have not been overpaid. Reconciliation is not the norm. Controls used at the time of payment should prevent the need for reconciliation. Payments on the out-of-balance contracts are delayed until the contracts are reconciled. As of September 30, 1995, the DFAS Columbus Center's records indicated that 15,060 of the 378,048 contracts it was responsible for paying through the Mechanization of Contract Administration Services system were out of balance and needed reconciliation. Approximately 3,029 of the out-of-balance contracts were overdisbursed (negative unliquidated obligations) by \$1.59 billion. At the time of the audit, the DFAS Columbus Center did not track reconciliations according to the contract's value.

Audit Objective. We assessed the effectiveness of the management of overdisbursed and unreconciled contracts at the DFAS Columbus Center and assessed actions taken to correct problems in those areas. We also evaluated the adequacy of the management control program for overdisbursed and unreconciled contracts as related to the audit objective.

Audit Results. Despite increased management emphasis on reconciling contracts to decrease overpayments, the number of overdisbursed contracts in the Mechanization of Contract Administration Services system at the DFAS Columbus Center increased from 2,692 contracts (overdisbursed by \$1.19 billion) in October 1994 to 3,029 contracts (overdisbursed by \$1.59 billion) in September 1995. This increased the risk of overpayments to contractors and the need for reconciliation of the contracts prior to payment (Finding A).

Although the DFAS Columbus Center made significant progress, it did not achieve the Deputy Secretary of Defense's goal of reducing 3,839 of its most pressing unreconciled problem contracts to 960 (a 75-percent reduction) by the end of calendar year 1995. As of December 31, 1995, 1,739 unreconciled contracts (a 55-percent reduction) were identified as most pressing. Personnel at the DFAS Columbus Center said the shortfall occurred partly because during calendar year 1995, they found additional contracts that needed reconciliation. Also, the DFAS Columbus Center did not include 12,688 other out-of-balance contracts in its plan to reduce its backlog of unreconciled contracts because, at the time of our audit, they did not believe that the 12,688 contracts contributed to the overpayment problem. The continued high level of unreconciled contracts may delay the payment of contractor invoices (Finding B).

This audit report identifies control weaknesses in the management of overdisbursed and unreconciled contracts. Recommendations in this report, if implemented, will help to reduce the number of overdisbursed contracts and identify all contracts at the DFAS Columbus Center that need reconciliation.

Summary of Recommendations. We recommend that the Director, DFAS Columbus Center, issue guidance to prevent and detect erroneous accounting entries that cause overdisbursements; expedite the system changes needed to make accounting errors more visible in the Mechanization of Contract Administration Services system; and identify and prioritize all existing contracts that need reconciliation. We also recommend that the Under Secretary of Defense (Comptroller) revise the goal for reducing the backlog of unreconciled contracts to 6 months of work load by the end of FY 1997, and develop a plan to reach that goal, using information from the DFAS Columbus Center on the scope of work involved.

Management Comments. The Deputy Chief Financial Officer, Office of the Under Secretary of Defense (Comptroller), consolidated comments from the DFAS with his response. Generally, his office and DFAS concurred or partially concurred with the findings and recommendations in the report. However, he nonconcurred with our recommendation to include all contracts that contain out-of-balance amounts in the plan for performing contract reconciliations. He stated that not all contracts containing overdisbursed or otherwise out-of-balance accounts should automatically be scheduled for a complete reconciliation. He stated that although such contracts should be reviewed, full reconciliation would be unnecessarily costly and time-consuming. He also stated that Headquarters, DFAS, and the DFAS Columbus Center were working to establish a feasible goal and a milestone plan to address the larger universe of contract review actions. See Part I for a summary of management comments and Part III for the complete text of the comments.

Audit Response. We agree that the scope of any contract reconciliation should depend on the extent of the out-of-balance condition. We also agree that a plan should be developed to address the larger universe of contract review actions. However, we believe that the first step in formulating the plan should be to include all out-of-balance contracts (including the larger universe of contract review actions) in the reconciliation backlog, even if the contracts require only minor adjustments. Reconciliation work load could then be scheduled according to the priority of all out-of-balance contracts. This will allow managers to measure progress in reducing the entire backlog, and will help them determine whether additional attention is needed to reduce and control all out-of-balance contracts.

We request that the Under Secretary of Defense (Comptroller) provide comments on this final report by August 5, 1996.

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Part I - Audit Results

Audit Background

The Defense Finance and Accounting Service (DFAS) Columbus Center, Columbus, Ohio, was established in January 1991 to consolidate payment functions previously carried out by the Defense Logistics Agency Finance Center, the Defense Contract Administration Services Regions, and their paying organizations. The mission of the DFAS Columbus Center's contract payment office is to make payments according to contractual, legislative, and regulatory requirements.

The DFAS Columbus Center makes contract payments using Army, Navy, Air Force, and other Defense agencies' appropriated funds. The DFAS Columbus Center processes about 80 percent of DoD contract payments using the Mechanization of Contract Administration Services (MOCAS) system. In FY 1995, the DFAS Columbus Center paid invoices valued at about \$60 billion using MOCAS.

After the consolidation of DoD accounting and finance operations in FY 1991, the DFAS Columbus Center addressed a number of problems with contract payments. Specifically, DFAS Columbus Center personnel corrected payments that were inaccurate because contracts contained erroneous financial information, were poorly written, or contained incomplete documentation. The DFAS Columbus Center also reduced the accounting errors that resulted in problem payments. The DFAS Columbus Center implemented corrective actions while continuing to make payments required by DoD contracts for work performed.

The incorrect payments caused many of the contracts in the MOCAS system to be overdisbursed (negative unliquidated obligations). A contract is overdisbursed when payment records indicate that the paying office has disbursed more funds than were obligated on the contract.

The erroneous payments made before and after the establishment of the DFAS Columbus Center created a great need for reconciliation of the contract imbalances. DFAS Columbus Center defines reconciliation as balancing the MOCAS contingent liability record against the contract, contract modifications, and disbursements. As of September 30, 1995, DFAS Columbus Center's records showed that 15,060 (4 percent) of its 378,048 contracts paid through MOCAS were out of balance and needed reconciliation; 3,029 of the out-of-balance contracts were overdisbursed by \$1.59 billion. DFAS Columbus Center personnel did not track reconciliations by the value of the contract.

Audit Objectives

The audit assessed the effectiveness of the management of overdisbursed and unreconciled contracts at the DFAS Columbus Center and actions taken to correct problems in those areas. See Part II, Appendix A, for a discussion of the scope, methodology, and management controls. We also evaluated the adequacy of the management control program for overdisbursed and unreconciled contracts as it pertained to the audit objective. See Part II, Appendix B, for a summary of prior audits and other reviews related to the audit objective.

Finding A. Management of Overdisbursed Contracts

The number of overdisbursed contracts (negative unliquidated obligations) in the MOCAS system at the DFAS Columbus Center increased significantly, by 337 contracts and \$400 million, during FY 1995. The total overdisbursed contracts increased from 2,692 contracts (overdisbursed by \$1.19 billion) in October 1994 to 3,029 contracts (overdisbursed by \$1.59 billion) in September 1995. The number of overdisbursements continued to rise because of external adjustments to contracts. Also, the DFAS Columbus Center did not complete the changes needed to improve and monitor the payment process. Not reducing the number of overdisbursed contracts delayed the identification of overpayments to contractors and increased the need for reconciliation of contracts prior to payment.

Reporting the Overdisbursement Problem

The DFAS Columbus Center identified and reported overdisbursed contracts as a material weakness in the FY 1993 and 1994 annual statements of assurance required by the Federal Managers' Financial Integrity Act.

In the FY 1994 statement of assurance, DFAS Columbus Center management stated that it was correcting the problems, but that overdisbursed contracts could not be completely eliminated because contract modifications can decrease obligations if payments have been made and funds are no longer available. As a result, management's goal changed from eliminating overdisbursed contracts at the contract level to implementing controls that would minimize overdisbursed contracts.

Increases in Overdisbursed Contracts

The DFAS Columbus Center was not able to keep overdisbursed contracts at an acceptable level. Instead, the number of overdisbursed contracts at the DFAS Columbus Center continued to rise during FY 1995.

During the 12-month period ending September 30, 1995, the number of overdisbursements rose by 337 contracts and \$400 million. The total overdisbursed contracts increased from 2,692 contracts (overdisbursed by \$1.19 billion) in October 1994 to 3,029 contracts (overdisbursed by \$1.59 billion) in September 1995 (see Appendixes C and D).

Finding A. Management of Overdisbursed Contracts

Causes of Overdisbursements Identified

DFAS Columbus Center personnel stated that the primary reasons for the increases in overdisbursed contracts were payment errors and decreases or adjustments to contractual obligations after payments had been made.

Management Reviews. Management reviews of the causes of overdisbursed contracts have shown that the primary reasons were payment errors and contract modifications that reduced the funding available on those contracts. DFAS Columbus Center management completed a review in March 1995. They found that contract adjustments, primarily downward adjustments after progress payments had been made, caused 56.6 percent of the overdisbursed contracts at the DFAS Columbus Center during January 1995. Accounting errors caused the remainder of the overdisbursements. Several previous management studies had identified similar causes.

Steps Taken to Prevent Overdisbursed Contracts

An interim policy memorandum from the DFAS Columbus Center's Director of Contract Entitlements in December 1994 stated that overdisbursed contracts at the Center had increased from \$421 million in June 1993 to more than \$1.1 billion in October 1994. The Director of Contract Entitlements stated that the large increase of overdisbursements at the contract level suggested a lack of controls in the entitlements operation at the DFAS Columbus Center.

To prevent further problem disbursements, the Director of Contract Entitlements instructed DFAS Columbus Center personnel to prepare a change to Desk Procedure No. 401, "Contract Entitlements," to incorporate strict guidance regarding the creation of overdisbursed contracts. She also stated that the DFAS Columbus Center planned to make a system change that would build internal controls into MOCAS. Such controls would provide systemic validation of funds availability at the contract level prior to disbursement.

In February 1995, the Director, DFAS Columbus Center stated that the Center was working to minimize overdisbursed contracts in its records and at the Defense Accounting Offices. He stated that the Center had implemented new policies, procedures, and internal controls to minimize overdisbursed contracts; was conducting reviews to identify the causes of newly created overdisbursed contracts; and was developing corrective actions.

Finding A. Management of Overdisbursed Contracts

Downward Contract Adjustments

Previous internal reviews by DFAS Columbus Center management had found that downward contract adjustments resulted in more than half (56.6 percent) of the overdisbursed contracts in January 1995. However, DFAS Columbus Center personnel stated that little could be done to reduce the effect of downward adjustments. They could only research the overdisbursements immediately after receiving the downward adjustment and the notification that the contract was out of balance, and could offset the overdisbursement or take collection action as necessary.

In December 1994, the Director of Contract Entitlements issued a policy memorandum requiring that when downward adjustments create overdisbursed conditions, they should be forwarded to the DFAS Columbus Center's reconciliation section to be researched.

Under Secretary of Defense (Comptroller) personnel stated that the downward adjustments resulted from decreases in contract prices or from reductions in allowable contractor overhead, based on reviews by the Defense Contract Audit Agency. The overdisbursements were not caused by errors in the computation or processing of payment requests, but by circumstances that changed during the life of a contract.

Further Actions Needed

Although DFAS Columbus Center personnel stated that little could be done about the contract modifications that reduced funding on contracts, they had not ensured that appropriate procedures were in place to prevent payment errors.

The December 1994 interim policy memorandum reminded the operating divisions to correct and prevent errors and conduct proper and thorough supervisory reviews. However, that guidance had not been incorporated into desk procedures at the Center. At the time of our audit, Desk Procedure No. 401, "Contract Entitlements," had not been updated to prohibit actions that could create an overdisbursed condition, such as manually forcing payments through the system when MOCAS had rejected those payments because of insufficient funds.

Also, at the time of our audit, the DFAS Columbus Center had not completed a system change request to incorporate internal controls that would systematically validate the availability of funds at the contract level before funds are disbursed. Validation was done for each accounting classification reference number, but not for each contract. Without a change to the MOCAS system, DFAS Columbus Center personnel had to manually research payments and could not easily validate the availability of funds.

Finding A. Management of Overdisbursed Contracts

Procedures for Management of Expiring Funds. In addition to downward contract adjustments and payment errors, DFAS Columbus Center personnel stated that a procedural change was a major cause of the increase in overdisbursed contracts to \$1.59 billion. Specifically, a "penny-down" program, instituted in FY 1993 to prevent the use of expired funds, caused 218 contracts to be reported as overdisbursed by more than \$248 million as of December 6, 1995, although sufficient funds were available for each contract.

The penny-down program was established to reduce to \$.01 those funds on contracts that were obligated but were unliquidated and were expiring, so that the funds could not be used after they expired. However, DFAS Columbus Center personnel stated that the combination of payments posted to incorrect accounting classification reference numbers on the 218 contracts, and the subsequent penny-down of funds on the proper accounting classification reference numbers, caused overdisbursements to be reported on the 218 contracts.

DFAS Columbus Center personnel stated that sufficient funds were available to cover the total payments on the contracts, but the payments were charged to incorrect accounting classification reference numbers. The subsequent penny-down of the funds on the correct accounting classification reference numbers caused the contracts to appear overdisbursed.

At the time of our audit, DFAS Columbus Center personnel were adjusting the penny-down program to continue to prevent the unauthorized use of expiring funds, while adjusting payments posted to the proper accounting classification reference numbers. DFAS Columbus Center personnel stated that a planned change in procedures would reduce the \$1.59 billion shown as overdisbursed by 218 contracts and \$248 million.

Prevalidation of Contract Payments. Although accounting errors in the DFAS Columbus Center's records were a primary cause of overdisbursed and unreconciled contracts, that problem could be alleviated by changes in DoD contract payment procedures.

Public Law 103-335 requires that disbursements be matched against obligations before payments are made. DoD began matching disbursements in excess of \$5 million on July 1, 1995. DoD also began matching disbursements in excess of \$1 million on October 1, 1995.

DFAS officials stated that when all contractor and vendor payments are validated against obligations before payments are made, accounting errors in the MOCAS system will be corrected. However, on October 1, 1995, the DFAS Columbus Center was exempted from the \$1 million threshold until October 1, 1996.

Finding A. Management of Overdisbursed Contracts

Summary

Overdisbursements at the DFAS Columbus Center continued to rise significantly in FY 1995. Although management acted to identify the causes of overdisbursements and reduce accounting errors that lead to overdisbursements, additional actions are needed. The DFAS Columbus Center should update desk procedures for the payment of contract entitlements, and should complete and implement system changes for MOCAS that will improve visibility over fund balances at the contract level.

Recommendations, Management Comments, and Audit Response

A. We recommend that the Director, Defense Finance and Accounting Service Columbus Center:

1. Immediately reissue the interim policy first published in December 1994 that prohibits creation of overdisbursed contracts, and expedite action to incorporate the guidance into Desk Procedure No. 401, Contract Entitlements.

Management Comments. The Deputy Chief Financial Officer, Under Secretary of Defense (Comptroller), partially concurred, stating that a revised Desk Procedure 401 was issued on February 7, 1996 (after issuance of the draft audit report). He indicated that the desk procedure is a working document, which clearly states that no disbursement transactions will be forced through MOCAS to create negative unliquidated obligations at the contract level. He also stated that the December 1994 policy does not need to be issued because it clearly states that payments creating negative unliquidated obligations at the contract level are not to be paid. The policy was previously issued by the DFAS Columbus Center and remains in effect.

2. Expedite the completion and processing of a systems change request that would incorporate internal controls into the Mechanization of Contract Administration Services system to provide for systematic validation of availability of funds at the contract level before funds are disbursed.

Management Comments. The Deputy Chief Financial Officer, concurred, stating that the recommended system change request has been written and funded as a priority. He stated that programming began in March 1996, and the estimated implementation date is October 1996.

Finding B. Reducing the Backlog of Unreconciled Contracts

Although the DFAS Columbus Center made significant progress, it did not achieve the Deputy Secretary of Defense's goal of reducing 3,839 of its most pressing unreconciled contracts to 960 (a 75-percent reduction) by the end of calendar year 1995. As of December 31, 1995, 1,739 unreconciled contracts (a 55-percent reduction) were identified as most pressing. Additionally, the DFAS Columbus Center did not include 12,688 other out-of-balance contracts in its plan to reduce the backlog of unreconciled contracts. These conditions occurred because the DFAS Columbus Center:

- o received a higher than expected inflow of contracts that urgently needed reconciliation,
- o did not process reconciliations as quickly as expected, and
- o concentrated resources on reconciling contracts that presented an immediate risk of overpayment, without evaluating and prioritizing the remaining unreconciled contracts.

The continuing high level of unreconciled contracts may delay DoD's payments to contractors.

Plan to Reduce Unreconciled Contracts

In a letter to the DoD Components in October 1994, the Deputy Secretary of Defense, to improve finance and accounting systems, set a goal of reducing DoD's backlog of unreconciled contracts by 75 percent by December 31, 1995.

DoD's implementation plan for the "Department of Defense Appropriations Act, 1995," Public Law 103-335, section 8137, was issued in February 1995. The plan stated that the backlog of unreconciled contracts at the DFAS Columbus Center was a major concern and must be eliminated to allow matching of obligations to disbursements before payment, and to avoid delays in payments to contractors and subsequent accrual of prompt payment interest. The implementation plan also stated that the DFAS Columbus Center had its own plan to reduce the backlog by 75 percent during calendar year 1995.

As of September 30, 1995, 15,060 contracts at DFAS Columbus Center were out of balance. At the time of our audit, the DFAS Columbus Center had not tracked and summarized the monetary value of the contracts.

Finding B. Reducing the Backlog of Unreconciled Contracts

Contract Reconciliation

Intensive Effort to Reconcile Contracts. In December 1994, the DFAS Columbus Center began an intensive effort to reconcile out-of-balance contracts and reduce the number of those contracts by 75 percent by December 31, 1995. That effort included hiring additional personnel, adding contractor support, increasing the use of software support, and monitoring the problem.

The DFAS Columbus Center's plan to reduce its backlog of unreconciled contracts by 75 percent included contracts that presented an immediate risk of overpayment. On September 30, 1994, the Center planned to reduce 3,839 unreconciled contracts to 960 (a 75-percent reduction) by the end of 1995.

Progress Toward Reducing the Backlog. By the end of September 1995, DFAS Columbus Center had made progress toward reducing the number of unreconciled contracts in its backlog. After the backlog increased to a maximum of 4,849 unreconciled contracts in February 1995, the number dropped steadily to 2,372 contracts by September 30, 1995.

However, progress was not as rapid as anticipated during the last 3 months of calendar year 1995; as of December 31, 1995, the DFAS Columbus Center had a backlog of 1,739 unreconciled contracts (considered by management to be those with the highest risk of overpayment and therefore in the greatest need of reconciliation), and fell short of its goal of reducing to 960 the number of contracts in the backlog by the end of calendar year 1995. The decrease was 55 percent.

Continued Inflow of Contracts in Need of Reconciliation. DFAS Columbus Center managers stated that they failed to reduce by 75 percent the number of contracts that urgently needed reconciliation because the inflow of new contracts in that category was greater than expected. The DFAS Columbus Center's records showed that from June through December 1995, the Center received an average of 1,192 new contracts in need of reconciliation. DFAS Columbus Center personnel had expected the inflow to be less than 1,000 new contracts each month.

DFAS Columbus personnel also said they had underestimated the time and resources needed to reconcile the contracts. Contract employees and DFAS Columbus Center staff had reduced the backlog by an average of 364 contracts each month from January through September 1995, and DFAS Columbus Center personnel had projected an average monthly reduction of 285 contracts through the end of calendar year 1995. Overtime was used to reduce the backlog quickly, but the work took longer than expected. The long hours created fatigue among the workers, especially during reconciliations of complex contracts. As a result, the average monthly reduction of unreconciled contracts from September through December 1995 slowed to 130 contracts per month.

Finding B. Reducing the Backlog of Unreconciled Contracts

Because of the slower pace, DFAS Columbus Center personnel could not reconcile the steady inflow of contracts in time to reach their goal. However, the number of reconciliations they completed was higher than the number of reconciliation requests they received, and they expected to reach the 75-percent goal in the early months of FY 1996.

Inventory of Contracts Requiring Reconciliation. The DFAS Columbus Center was making progress toward a 75-percent reduction of the high-priority unreconciled contracts in its backlog. However, the Center had not included and prioritized 12,688 other contracts that required reconciliation. On September 30, 1995, 15,060 out-of-balance contracts at the DFAS Columbus Center needed reconciliation. However, the Center was attempting to reconcile only the most pressing out-of-balance contracts. An additional 12,688 out-of-balance contracts were not included in the backlog.

Defining Unreconciled Contracts. Personnel at the DFAS Columbus Center stated that four types of problems caused contracts to need reconciliation:

- o contract modifications decreased available contract funding below the level of funds paid,
- o insufficient funds were available to pay invoices,
- o a procuring contracting officer or administering contracting officer requested that a contract be reconciled, or
- o a funding station requested that a contract be reconciled.

In September 1995, 2,372 contracts met at least one of these criteria.

Also, 12,688 other contracts at the DFAS Columbus Center required reconciliation. DFAS Columbus Center personnel defined those contracts as review contracts and did not include them in the backlog of contracts that needed reconciliation.

The review contracts consisted of contracts in need of financial adjustment, including those with overdisbursements, but for which no one had requested reconciliation. DFAS Columbus Center personnel stated that those contracts could eventually become part of the reconciliation backlog.

Increases in Unreconciled Contracts. Personnel at the DFAS Columbus Center said that no differences existed between the contracts in the reconciliation and review categories. They said that, in general, review contracts were out-of-balance contracts that required reconciliation. However, because there was no immediate risk of overpayment, the review contracts were not included in the reconciliation backlog.

The DFAS Columbus Center reported progress in reducing the number of its most pressing reconciliations. Although that number had decreased from 4,337 in January 1995 to 2,372 in September 1995, the other contracts in need of reconciliation (those in the review category) had increased from 10,320 in

Finding B. Reducing the Backlog of Unreconciled Contracts

January 1995 to 12,688 in September 1995. As shown in Appendix E, the total number of out-of-balance contracts (in both the reconciliation and review categories) at the DFAS Columbus Center increased from 14,657 in January 1995 to 15,060 in September 1995.

Meeting the Intent of the Reconciliation Goal

The continued existence of large numbers of out-of-balance contracts will prevent the DFAS Columbus Center from meeting its reconciliation goal, which is to reduce the risk of overpayments and delayed payments on contracts.

Attempting to reduce by 75 percent the backlog of unreconciled contracts is not a meaningful goal. Even if the DFAS Columbus Center achieves this goal, other out-of-balance contracts in the Center's MOCAS system records, including review contracts, may delay DoD's payments to contractors. This is because matching disbursements to obligations before payment will force time-consuming reconciliations of contracts.

Contract reconciliations performed after the receipt of invoices will delay payments. For example, in July 1995, the DFAS Columbus Center was required to prevalidate 130 invoices with a total value of \$5 million or greater before payment could be made. Because of the out-of-balance conditions between MOCAS and the official accounting systems, 33 invoices (25 percent) of the 130 invoices requiring prevalidation in July 1995 were rejected, and payments delayed until the DFAS Columbus Center resolved the problems. Such delayed payments cause DoD to waste resources to pay the resulting prompt payment penalties.

Summary

Although DFAS Columbus Center managers were attempting to reconcile out-of-balance contracts that could result in immediate overpayments, the inflow of new contracts in that category was underestimated and prevented the Center from reducing the backlog by its 75-percent goal by the end of calendar year 1995. Also, other contracts, categorized as review contracts, were not being prioritized and reported. Contracts in the review category should be added to the DFAS Columbus Center's reconciliation backlog because those contracts will eventually require reconciliation. By not including the review contracts in the backlog, the DFAS Columbus Center distorts the magnitude of the problem of reconciliation. Also, by not including all contracts in need of reconciliation in its goal, and by not adequately researching and prioritizing the contracts that should be reconciled, management is less aware of the effort needed to solve the problem of unreconciled contracts and correct contract imbalances in the MOCAS system.

Finding B. Reducing the Backlog of Unreconciled Contracts

Recommendations, Management Comments, and Audit Response

B.1. We recommend that the Director, Defense Finance and Accounting Service Columbus Center, analyze and prioritize all contracts, and include contracts that contain overdisbursed or otherwise out-of-balance amounts in the plan for performing contract reconciliations.

Management Comments. The Deputy Chief Financial Officer nonconcurred. He stated that analyzing and prioritizing contracts that have been identified for reconciliation is a sound concept. However, he stated that not all contracts containing overdisbursed or otherwise out-of-balance accounts should automatically be scheduled for complete reconciliation. He stated that although such contracts should be reviewed, a full contract reconciliation would be unnecessarily costly and time-consuming.

Audit Response. We agree that some out-of-balance contracts have a lower priority for reconciliation than others. However, any contract that must be analyzed because of an out-of-balance condition, and is subsequently balanced by means of an adjustment, is undergoing a reconciliation. Therefore, all out-of-balance contracts should be recognized in the reconciliation backlog. Because all out-of-balance contracts require some reconciliation, separating the out-of-balance work load into reconciliation and review categories is unnecessary.

At the time of our audit, only 2,372 out of 15,060 (16 percent) of the out-of-balance contracts were included in the reconciliation backlog, and we found no evidence that contracts that were not included (the review category) had been evaluated and prioritized. The comments of the Deputy Chief Financial Officer on Recommendation B.2., summarized below, indicate that management is developing a goal and a milestone plan to deal with contracts in the review backlog. The plan should include all out-of-balance contracts in the reconciliation backlog, and each out-of-balance contract should be prioritized and reconciled appropriately. The extent of the reconciliation will depend on the extent of the out-of-balance condition, but the DFAS Columbus Center should not conduct an extensive reconciliation effort if one is not needed. We request that the Under Secretary of Defense (Comptroller) reconsider his position and provide additional comments in response to the final report.

B.2. We recommend that the Under Secretary of Defense (Comptroller) establish a revised goal for reducing the backlog of unreconciled contracts to 6 months of backlogged work load by the end of FY 1997, and develop a plan to reach the goal using information from the DFAS Columbus Center on the scope of work involved.

Management Comments. The Deputy Chief Financial Officer partially concurred, stating that a new goal will be set for the reconciliation work load. That goal, which will be "no more than the normal 60-day on-hand pipeline of inflowing contracts for reconciliation," should be achieved by the end of FY 1997. He also stated that Headquarters, DFAS, and the DFAS Columbus

Finding B. Reducing the Backlog of Unreconciled Contracts

Center are working to establish a feasible goal and a milestone plan to address the larger universe of contract review actions. He stated that the goal and plan for contract reviews will be established within 90 days of the date of his comments.

Part II - Additional Information

Appendix A. Scope and Methodology

Scope

We evaluated management's actions to reduce the number of overdisbursed and unreconciled contracts and to improve the contract reconciliation process at the DFAS Columbus Center. We also evaluated the DFAS Columbus Center's plans to correct problems with overdisbursed and unreconciled contracts. We evaluated the reasonableness and feasibility of actions taken and planned.

Methodology

We obtained information on overdisbursed and unreconciled contracts from the DFAS Columbus Center's records or compiled it from those records. To identify problems with overdisbursed and unreconciled contracts and determine what corrective actions were planned, we reviewed audit reports, management reports, action plans, results of actions taken, and the DFAS Columbus Center's annual statement of assurance for the DoD management control program. We also evaluated five contract reconciliations performed under contract for the DFAS Columbus Center; evaluated high-risk areas related to overdisbursed and unreconciled contracts; reviewed the results of contract reconciliations performed by a contractor for the DFAS Columbus Center; and visited four Defense Accounting Offices to compare the DFAS Columbus Center's computer records with official accounting records.

We reviewed the plan developed and implemented by DFAS Columbus Center management in FY 1994 to manage unreconciled contracts, and related supporting data. We also reviewed productivity data for prior contract reconciliations performed by an accounting firm for the DFAS Columbus Center from FY 1990 through 1995. We evaluated the reconciliation backlog, the review backlog, and the inflow of reconciliation and review contracts for their effect on DoD's effort to match disbursements with obligations before payments are made. The principal test we used to determine the effectiveness of the DFAS Columbus Center's reconciliation program was the degree of change in the out-of-balance conditions in the MOCAS contingent liability record, which is shown when disbursements exceed obligations.

Use of Computer-Processed Data. We performed limited tests of the reliability of computer-processed MOCAS data from the DFAS Columbus Center. The numbers and values of overdisbursements and unreconciled contracts in this report are based on information provided to us by the DFAS Columbus Center and were not audited. Except for a judgmental sample of computer-processed data on overdisbursed contracts, we did not assess the reliability of computer data obtained from the DFAS Columbus Center because

inaccuracies in computer-processed contract data are a recognized problem for the Center and cause a majority of its overdisbursed and unreconciled contracts.

Audit Period, Standards, and Locations. We conducted this economy and efficiency audit from November 1994 through August 1995. The audit was made in accordance with auditing standards issued by the Comptroller General of the United States as implemented by the Inspector General, DoD. Accordingly, we included such tests of management controls as were considered necessary. Appendix F lists the organizations we visited or contacted.

Management Control Program

DoD Internal Management Control Program. DoD Directive 5010.38, "Internal Management Control Program," April 14, 1987, requires all DoD organizations to have management controls over their operations and to perform periodic self-evaluations of those management controls. We reviewed the DFAS Columbus Center's management control program.

Scope of Review of Management Control Program. We reviewed Government and DoD criteria requiring that controls be established to ensure that funds are properly spent. Specifically, we reviewed the Office of Management and Budget Circular No. A-127, "Financial Management Systems," July 1993; DoD Directive 5010.38, "Internal Management Control Program," April 14, 1987; DoD Directive 7200.1, "Administrative Control of Appropriations," July 1987; DoD Regulation 7000.14-R, "Financial Management Regulation," volume 4, January 1995, and volume 5, December 1993. We reviewed the Defense Logistics Agency Manual 4745.22, "Mechanization of Contract Administration Services (MOCAS) Automated Data System (ADS) Manual," May 25, 1988. At the DFAS Columbus Center, we reviewed position descriptions, desk procedures, reports of management control reviews, internal audit reports, self-evaluations of applicable management controls, and management plans to correct reported material weaknesses. We reviewed reports issued by the General Accounting Office and the Inspector General, DoD, on related problems with overdisbursed and unreconciled contracts at the DFAS Columbus Center (see Appendix B).

Adequacy of Management Controls. We found material management control weaknesses, as identified by DoD Directive 5010.38, related to overdisbursed and unreconciled contracts at the DFAS Columbus Center. Specifically, the Center had not ensured that the number of overdisbursed contracts was reduced and that its reconciliation backlog included all contracts that needed reconciliation. If implemented, Recommendations A.1., A.2., B.1., and B.2. in Part I of this report will help correct the previously reported weaknesses. A copy of the report will be provided to the senior official in charge of management controls at the DFAS Columbus Center.

Appendix A. Scope and Methodology

Adequacy of Management's Self-Evaluation. The DFAS Columbus Center conducted the required self-evaluations and reported uncorrected material management control weaknesses related to overdisbursed and unreconciled contracts. For FY 1994, the DFAS Columbus Center reported tentative overdisbursements (negative unliquidated obligations) and other issues related to unreconciled contracts as uncorrected material weaknesses in its annual statement of assurance for the management control program. The DFAS Columbus Center also reported plans to correct those weaknesses by the end of FY 1995.

Appendix B. Summary of Prior Audits and Other Reviews

The General Accounting Office and the Inspector General, DoD, issued eight audit reports from January 1990 through January 1995 that were related to our audit objective. DFAS Columbus Center management also conducted three related reviews during FY 1994 and the first quarter of FY 1995. The eight audits and the three reviews are summarized below.

General Accounting Office Reports

GAO/AIMD 95-7 (OSD Case No. 9618-A), "Status of Defense Efforts to Correct Disbursement Problems," October 5, 1994, concluded that because of weaknesses in control procedures and DoD fund control systems, DoD had problems with properly matching disbursements to corresponding obligations. The GAO recommended resolving weaknesses in control procedures that allow problem disbursements to occur, and also recommended improving DoD systems for contract payments and accounting. DoD concurred with the recommendations and was changing procedures and systems during our audit.

GAO/NSIAD 94-245 (OSD Case No. 9742), "Overpayments and Underpayments at Selected Contractors Show Major Problem," August 5, 1994, reported that nine contractors had \$30 million in overpayments and \$87 million in underpayments, based on the contractors' records. The report stated that unless DoD used the contractors' records to identify payment problems not identified in DFAS records, the extent of contracts requiring reconciliation would be unknown. The report recommended that DoD mobilize contract, finance, and audit resources and use both contractor and Government records to identify and correct contract payment problems. The Under Secretary of Defense (Comptroller) partially concurred with the recommendation, but stated that many short-term and long-term actions were under way to reduce the risk of over- and underpayments.

GAO/NSIAD 94-106 (OSD Case No. 9602), "Millions in Overpayments Returned by DoD Contractors," March 14, 1994, concluded that the DFAS Columbus Center received millions of dollars in returned contract overpayments largely because of unrecovered progress payments or duplicate payments. The report made no recommendations for corrective action.

Inspector General, DoD, Reports

IG, DoD, Report No. 95-046, "Data Input Controls for the Mechanization of Contract Administration Services System," November 30, 1994, reported that

Appendix B. Summary of Prior Audits and Other Reviews

the MOCAS system accepted invalid data and that edit tables were not being used, which allowed negative unliquidated obligations, unmatched disbursements, and incorrect or duplicate payments. Data rejected at initial input were not properly managed, and controls were not adequate to prevent unauthorized access to the MOCAS system. The Deputy Comptroller (Financial Systems) concurred with the need to issue guidance and implement controls. Implementation is expected in FY 1996.

IG, DoD, Report No. 94-144, "Controls Over Two Contract Payments at the Defense Finance and Accounting Service Columbus Center," June 20, 1994, concluded that contractor invoices totaling \$15.9 million were not adequately verified prior to payment, and that when the resulting overpayments were identified, recoupment actions were not taken properly or promptly. The report recommended that the DFAS Columbus Center require contractor invoices to be verified prior to payment, and implement formal procedures for the immediate refund of overpayments. The Deputy Director for Finance, DFAS, concurred, stating that safeguards were being strengthened and new procedures implemented to verify invoices and have contractors immediately submit overpayments to disbursing offices.

IG, DoD, Report No. 94-054, "Fund Control Over Contract Payments at the Defense Finance and Accounting Service Columbus Center," March 15, 1994, concluded that obligation and disbursement data in the automated system were not accurate, and that procedures for controlling appropriation fund data were not adequate to allow the Military Departments' accountable stations to properly record disbursements and maintain their accounting records. The Director, DFAS, and the Director, DFAS Columbus Center, concurred with the recommendation to terminate the reconciliation services of a commercial accounting firm, but nonconcurred with the recommendation to terminate the interface with the Military Standard Contract Administration Procedures system. The DFAS Columbus Center planned to convert to a new system by December 1995.

IG, DoD, Report No. 92-076, "Administration of the Contract Closeout Process Within DoD," April 15, 1992, stated that contract data in the MOCAS system were inaccurate and contributed to delays in closing contracts. The report recommended that the DFAS Columbus Center develop and implement procedures to better maintain complete and accurate finance files, train personnel to properly input contract data into the automated system, and collect overpayments. The Director, DFAS Columbus Center, concurred with the finding and recommendations and stated that he was establishing procedures to better control payment files, verify that financial data were accurately input into the MOCAS system, and collect overpayments.

IG, DoD, Report No. 92-028, "Merged Accounts of the Department of Defense," December 30, 1991, reported that DoD's merged accounts contained over \$1.8 billion in unmatched disbursements and \$1 billion in negative unliquidated obligations. The report recommended that the Under Secretary of Defense (Comptroller) require the Director, DFAS, to emphasize account accuracy in order to reduce unmatched disbursements, and formally investigate all overdisbursed appropriations and their subaccounts to resolve potential

Appendix B. Summary of Prior Audits and Other Reviews

violations of the Antideficiency Act. The Deputy Comptroller (Management Systems) partially concurred with the recommendations, stating that his office was working toward automated systems to reduce accounting errors. He also stated that he would review policies to determine whether additional restrictions are required for funds to be restored, pending full justification and approval of unrecorded obligations.

DFAS Columbus Center's Management Reviews

An internal review report by the DFAS Columbus Center, "Followup Review on Payments Made Against the Wrong Accounting Classification Reference Number," was issued on July 27, 1994. The error rate for payments made against incorrect accounting classification reference numbers had decreased from 6.8 percent to 2 percent. Of 504 payments reviewed, 2 percent had the incorrect accounting classification reference number. The report recommended that management ensure that desk procedures were followed and quality reviews were performed to further reduce payments made against incorrect accounting classification reference numbers.

The DFAS Columbus Center's Quality Assurance Division issued a report, "Negative Unliquidated Obligations Created by Modifications," on November 17, 1994. The report stated that 50 percent of negative unliquidated obligations resulted from contract modifications. Also, about 30 percent of the negative unliquidated obligations examined did not have proper authorization or documentation. Controls over payments forced through the system were weak, and desk procedures were lacking.

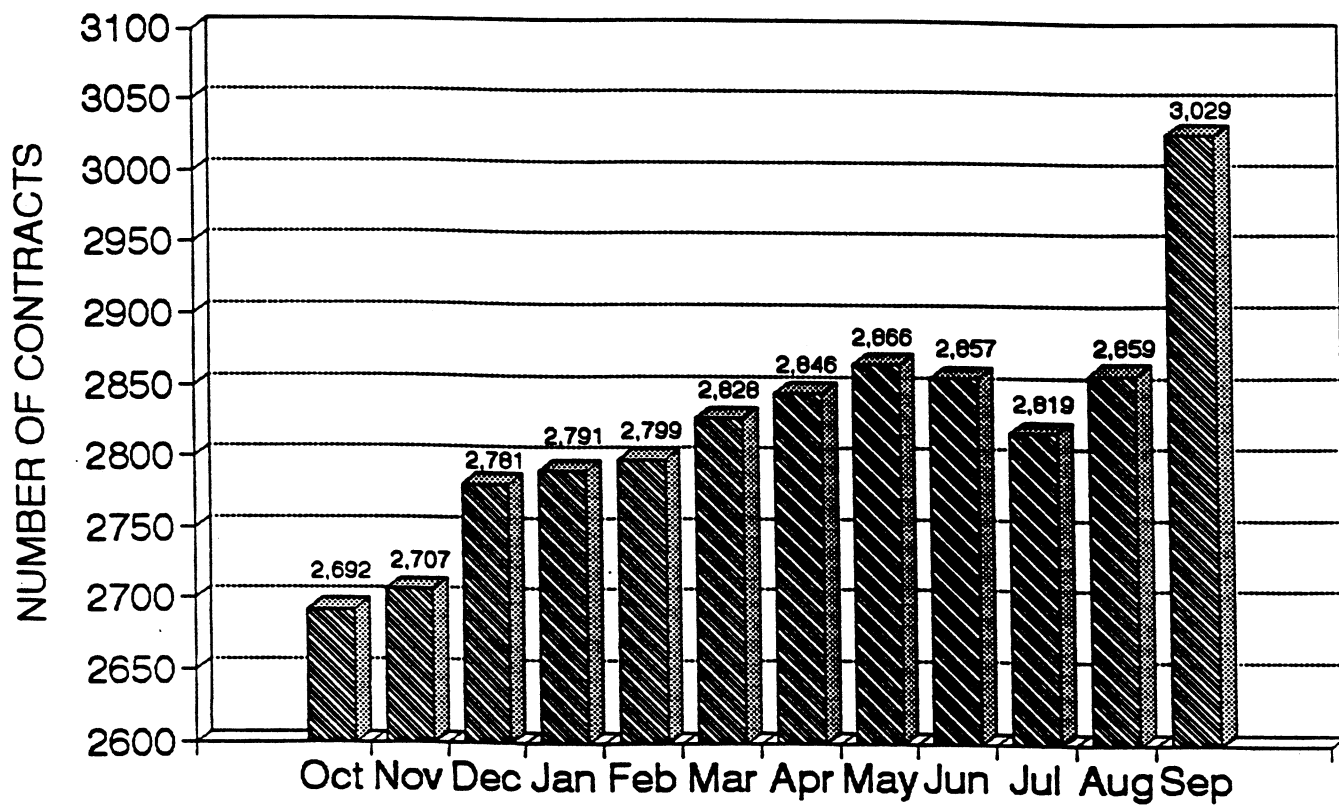
The DFAS Columbus Center's Quality Assurance Division issued a report, "Contract Reconciliation," on December 21, 1994. The following nine weaknesses were reported.

- o Procedures for making adjustments were not followed.
- o Controls over access to computer data were weak.
- o Negative unliquidated obligations were not processed promptly by most divisions.
- o The backlog of unreconciled contracts was not adequately monitored.
- o Existing procedures were vague.
- o Supervisors did not always perform quality reviews of completed reconciliations.

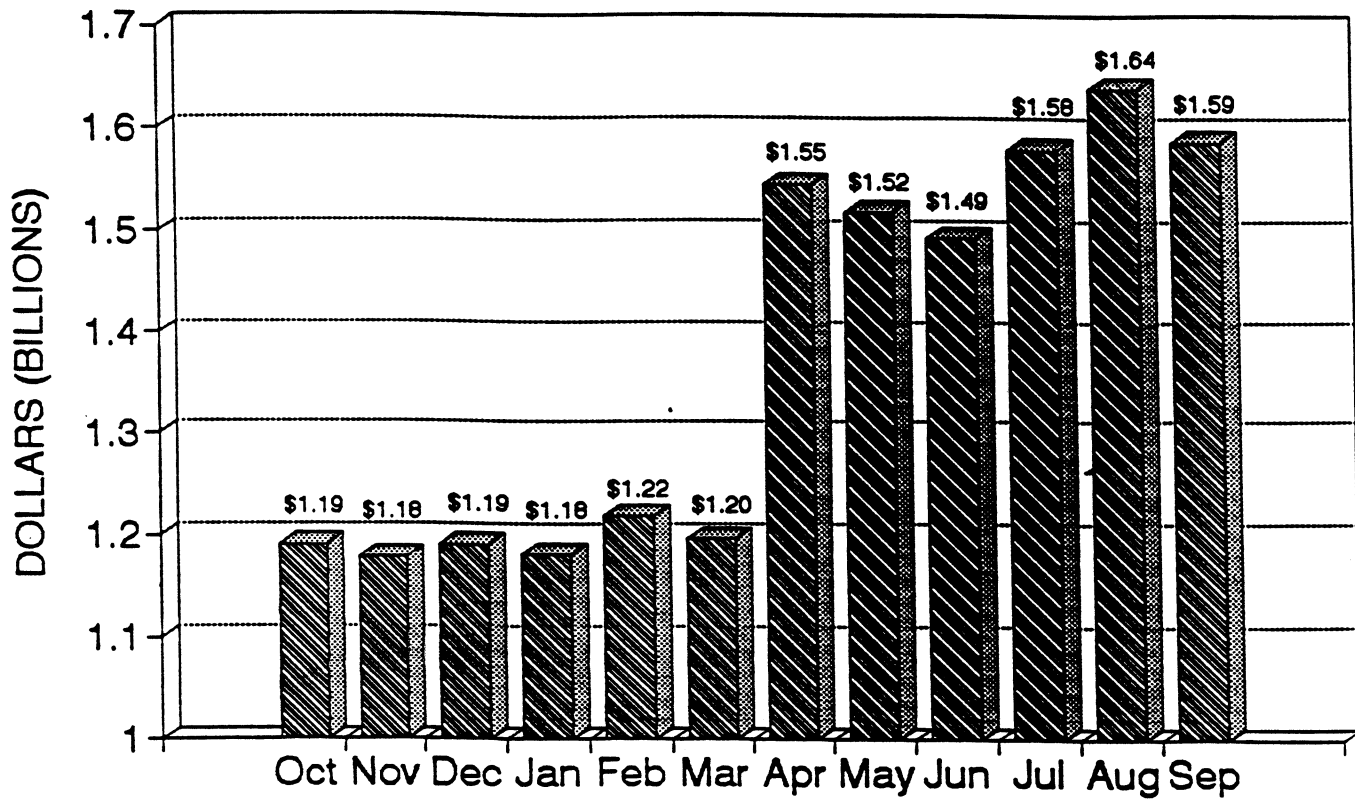
Appendix B. Summary of Prior Audits and Other Reviews

- o The automated reconciliation program was not widely used.
- o Standards for completing reconciliation requests were vague.
- o Adjustments were not processed properly.

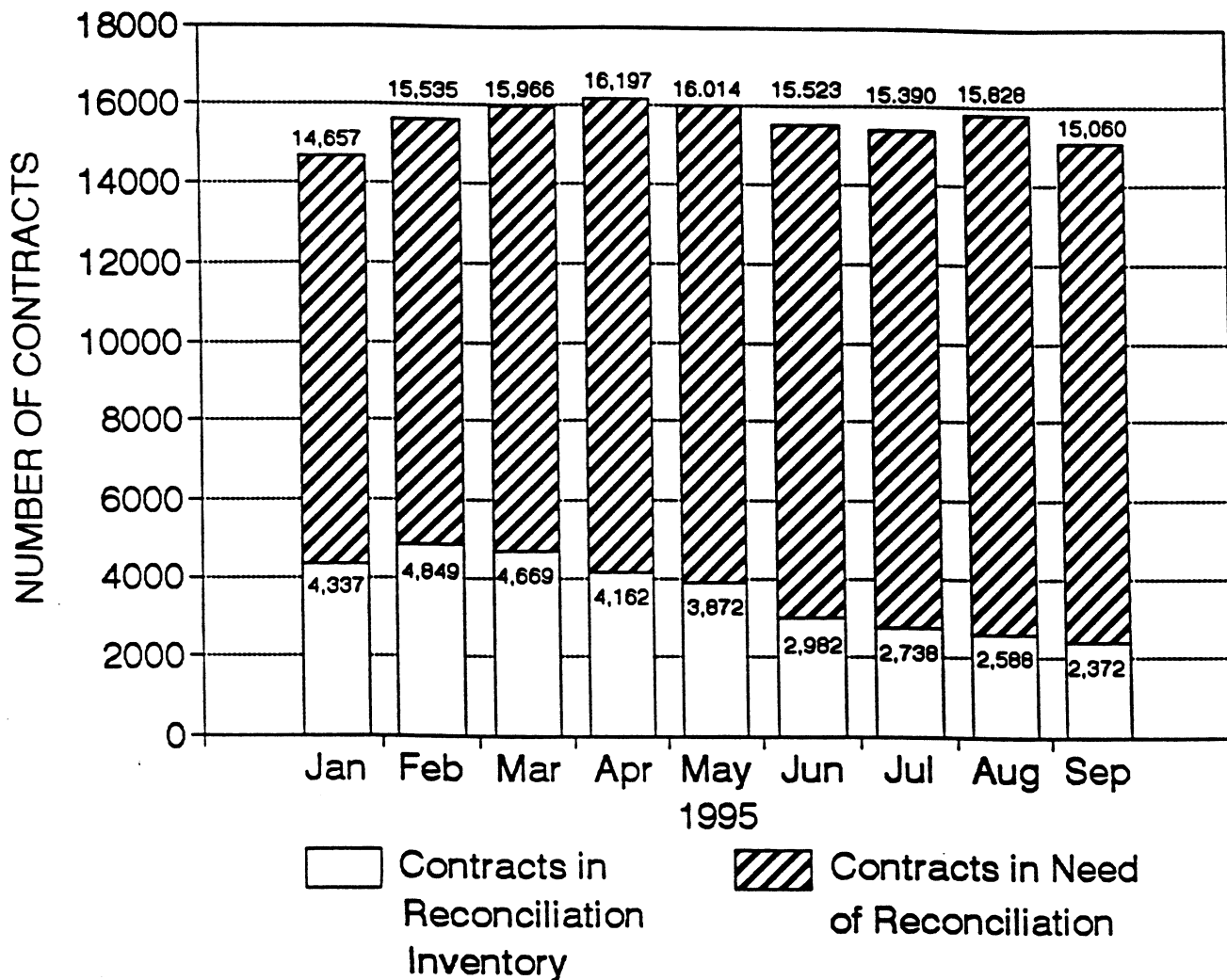
Appendix C. FY 1995 Overdisbursed Contracts (by Number of Contracts)



Appendix D. FY 1995 Overdisbursed Contracts (Billions of Dollars)



Appendix E. Contracts in Need of Reconciliation



The DFAS Columbus Center did not include all contracts in need of reconciliation in its backlog. Although the number of contracts in the reconciliation backlog was being reduced, the total number of contracts in need of reconciliation had increased from January through September 1995.

Appendix F. Organizations Visited or Contacted

Office of the Secretary of Defense

Deputy Under Secretary of Defense (Comptroller)

Department of the Army

Assistant Secretary of the Army (Financial Management and Comptroller),
Washington, DC
Army Missile Command, Huntsville, AL

Department of the Navy

Assistant Secretary of the Navy (Financial Management and Comptroller),
Washington, DC
Naval Criminal Investigative Service, Washington, DC

Department of the Air Force

Air Force Materiel Command, Wright-Patterson Air Force Base, OH
Warner Robins Air Logistics Center, Robins Air Force Base, GA

Other Defense Organizations

Defense Finance and Accounting Service, Arlington, VA
Defense Finance and Accounting Service Columbus Center, Columbus, OH
Defense Finance and Accounting Service Denver Center, Denver, CO
Defense Finance and Accounting Service Indianapolis Center, Indianapolis, IN
Defense Accounting Office, Robins Air Force Base, GA
Defense Accounting Office, Army Missile Command, Huntsville, AL
Defense Accounting Office, Army Tank-automotive Command, Warren, MI

Appendix G. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense (Comptroller)
Deputy Chief Financial Officer
Deputy Comptroller (Program/Budget)
Assistant to the Secretary of Defense (Public Affairs)
Director, Defense Procurement
Director, Defense Logistics Studies Information Exchange
Director, Management Improvement

Department of the Army

Assistant Secretary of the Army (Financial Management and Comptroller)
Auditor General, Department of the Army

Department of the Navy

Assistant Secretary of the Navy (Financial Management and Comptroller)
Auditor General, Department of the Navy

Department of the Air Force

Assistant Secretary of the Air Force (Financial Management and Comptroller)
Auditor General, Department of the Air Force

Other Defense Organizations

Director, Defense Contract Management Command
Director, Defense Contract Management District International
Director, Defense Finance and Accounting Service
Director, Defense Finance and Accounting Service Columbus Center
Director, Defense Logistics Agency
Director, National Security Agency
Inspector General, National Security Agency

Appendix G. Report Distribution

Non-Defense Federal Organizations

Office of Management and Budget

National Security Division, Special Projects Branch

General Accounting Office

National Security and International Affairs Division, Technical Information Center

National Security and International Affairs Division, Defense Management Issues

National Security and International Affairs Division, Military Operations and
Capabilities Issues

Chairman and ranking minority member of each of the following congressional
committees and subcommittees:

Senate Committee on Appropriations

Senate Subcommittee on Defense, Committee on Appropriations

Senate Committee on Armed Services

Senate Committee on Governmental Affairs

House Committee on Appropriations

House Subcommittee on National Security, Committee on Appropriations

House Committee on Government Reform and Oversight

House Subcommittee on National Security, International Affairs and Criminal

Justice, Committee on Government Reform and Oversight

House Committee on National Security

Part III - Management Comments

Under Secretary of Defense (Comptroller) Comments



COMPTROLLER

OFFICE OF THE UNDER SECRETARY OF DEFENSE
1100 DEFENSE PENTAGON
WASHINGTON, DC 20301-1100



APR 24 1993

MEMORANDUM FOR ACTING DIRECTOR, FINANCE AND ACCOUNTING
DIRECTORATE, DEPARTMENT OF DEFENSE INSPECTOR
GENERAL

SUBJECT: Audit Report on Overdisbursed and Unreconciled Contracts at the Defense
Finance and Accounting Service Columbus Center (Project No. 5FJ-5011)

This is a consolidated Office of the Under Secretary of Defense (Comptroller) and
Defense Finance and Accounting Service (DFAS) response to the subject draft audit report.

Generally, this office and the DFAS concur or partially concur with the findings and
recommendations in the subject draft report. However, not all contracts that contain
overdisbursed or otherwise out-of-balance accounts should automatically be scheduled for a
complete contract reconciliation. Although all such contracts should be reviewed, a full contract
reconciliation would be unnecessarily costly and time consuming. Attached are detailed
comments regarding the findings and recommendations of the subject audit report.

This office appreciates the opportunity to comment on the draft report. My staff point of
contact for this matter is Mr. Henry Bezold. He may be reached at (703) 614-3523.

Alvin Tucker
Deputy Chief Financial Officer

Attachment

**DOD IG DRAFT AUDIT REPORT,
"OVERDISBURSED AND UNRECONCILED DOD CONTRACTS AT THE
DEFENSE FINANCE AND ACCOUNTING SERVICE - COLUMBUS CENTER"
DATED JANUARY 26, 1996
(PROJECT NUMBER 5FJ-5011)**

GENERAL COMMENTS

The following general comments are offered to improve the understanding, tone, clarity, and accuracy of the subject report. As presently written, the report suggests an unaddressed problem of \$1.5 billion. In fact, most of the \$1.5 billion identified in the report as contract overdisbursements is already in reconciliation; has been created by externally driven actions such as "penny down" adjustments; or is subject to ongoing litigation or active collection action.

THE NATURE OF OVERDISBURSEMENTS

An overdisbursement of an obligation does not always indicate that the Department has made, and many of the cited overdisbursements do not represent, actual overpayments to contractors. Throughout the report, the term overdisbursed is used instead of "negative unliquidated obligation." To many readers, the term overdisbursed is synonymous with overpaid. Too often, an overpayment is incorrectly assumed to be caused by a payment error made by the payment office. In fact, in many cases, overdisbursements are the result of a legal contracting action.

Overdisbursements (or more appropriately, negative unliquidated obligations) often are caused by legal contract modifications. Many Department of Defense contracts require financing payments to contractors before actual work is completed or a delivery is made. These financing payments often are based upon pricing estimates and are scheduled regularly throughout the life of the contract. Payment offices make the financing payments in accordance with contract provisions, until the contract is completed or a contract modification changes the payment amount. Quite often, a legal contract modification will change a contract pricing estimate; yet such changes may not be effective until after the contractor receives the financing payment. When this happens, a temporary negative unliquidated obligation is created. Payment offices then must make a collection according to the terms of the newly modified contract.

DETERMINING THE TRUE REDUCTION TO CONTRACT RECONCILIATIONS

The Defense Finance and Accounting Service-Columbus Center reduced the contract reconciliation backlog by 69 percent between October 1994 and the end of December 1995. The Department of Defense set an aggressive goal to reduce unreconciled contracts by 75 percent by the end of December 1995. The 75 percent reduction goal only applied to backlogged contracts that needed corrective action to reduce the chance of contractor overpayments. During April 1995, several funding stations asked the Columbus Center to accept additional reconciliation workload outside the previously established FY 95 workload planning cycle. The Columbus Center accepted an additional 761 contracts for reconciliation and appropriately recalculated the baseline on which a reduction should occur. Although over half the fiscal year was completed

when the additional workload was accepted, the Columbus Center still achieved a 69 percent reduction against the total FY 1995 contract reconciliation backlog. (See below)

Reconciliation Workload To Be Reduced	
Balance October 1994	3,839
Add - April 1995 increase to baseline	761
Less - Steady State 60-day pipeline	(480)
Total Backlog To Be Reduced	4,120
Balance of Backlog To Be Reduced	
Total Balance 31 December 1995	1,739
Less - Steady State 60 day pipeline	(480)
Total Backlog on 31 December 1995	1,259
Total Reduction	
Total Backlog To Be Reduced	4,120
Total Backlog on 31 December 1995	1,259
Total Backlog Reduction Achieved	2,861
Reduction Percentage	69.4%

A CONTRACT RECONCILIATION VERSUS A CONTRACT REVIEW

Contract reconciliations and contract reviews are significantly different in scope and magnitude. Although the goal of both is to correct contract discrepancies, the time and effort needed are significantly different. The management measurements should not be combined. Not all contracts require a complete reconciliation. Some may require just a review--a much less extensive effort.

Full contract reconciliations are labor intensive and consequently expensive. Reconciliations are usually caused by greater contract complexities--the contract has a high dollar value, is old, and contains many modifications. When discrepancies are discovered, because of the age and volume of transactions, the solution may not be immediately apparent. The discrepancy may trigger a complete audit of all prior transactions leading to the current problem. This could be compared to trying to balance your checkbook for the first time in a number of years.

In contrast, contract reviews are much less resource intensive. The actions are usually fairly simple with obvious solutions. They usually can be completed within a relatively short time under the normal course of the contract disbursing process.

Because a contract reconciliation and a review differ, the management of the contract reconciliation process and contract review process requires different attention. Consequently, they are separately categorized, prioritized, resourced, managed, and measured on a day-to-day basis. Because they differ in scope and magnitude, the measurement of reconciliation and review efforts provide management with discretely different work in process and resource demands.

FINDINGS

Finding A. Management of Overdisbursed Contracts: The number of overdisbursed contracts in the MOCAS at the DFAS-Columbus Center increased significantly (by 337 contracts and \$400 million) during FY 1995. In total, overdisbursed contracts increased from 2,692 contracts (overdisbursed by \$1.19 billion) in October 1994 to 3,029 contracts (overdisbursed by \$1.59 billion) in September 1995. The number of overdisbursements continues to rise because of externally driven adjustments to contracts. Also, DFAS-Columbus Center did not complete the changes needed to improve and monitor the payment process. Not reducing the number of overdisbursed contracts increased the risk of overpayments to contractors and increased the need for reconciliation of contracts prior to payment.

OUSD(C)Response: Nonconcur. The number and value of contracts carrying a negative unliquidated obligation in the MOCAS at the DFAS-Columbus Center did increase during FY 1995. However, out of the 3,029 contracts, the number of contracts not in some stage of review or reconciliation was only 1,842, with only \$238 million in NULOs. This number--1,842-- is what remains after considering those cases in litigation, those cases for which the Columbus Center already has issued a Demand Letter (letter requesting payment) and those contracts with externally driven adjustments.

An analysis of the 3,029 contracts reveals that at the time of the audit, 737 contracts equaling \$878 million in NULOs, or 55 percent of the \$1.59 billion in NULOs, had planned or completed actions as shown below:

	Number of Contracts	NULO Value
Part of Current Reconciliation Effort	253	\$818 Million
Demand Letters Already Issued	243	\$ 14 Million
In Litigation	241	\$ 46 Million
	737	\$878 Million

Four hundred fifty contracts, with a NULO value of \$273 million, should have been excluded because they resulted from adjustments made by the DFAS-Columbus Center to preclude payments against canceled accounts vice involving actual overdisbursements. Due to the MOCAS system configuration, the most effective way to preclude payments against canceled accounts is to reduce unliquidated balances on canceled account accounting lines to \$.01. While preventing improper payments, this procedure does result in an understatement of the total contract value; and therefore, can give the appearance of an overpayment when, in fact, no overpayment exists.

Under Secretary of Defense (Comptroller) Comments

The remaining 1,842 contracts, having a NULO value of \$238 million, as of November 30, 1995, is the real issue. The DFAS-Columbus Center had initiated \$56 million in adjustments affecting these contracts by November 30, 1996. That left \$238 million to be researched and resolved. Furthermore, those contracts have been prioritized for review or reconciliation as stated in the following paragraphs.

Since the audit, the DFAS Columbus Center scheduled additional reconciliations for 21 of the largest contracts carrying a negative unliquidated obligation. These 21 contracts represented 65 percent of the total NULO dollar value. Unless circumstances are discovered which create a need to schedule a full reconciliation, the remaining contracts are scheduled only for a review. The following table provides a stratification of the 1,842 contracts carrying a negative unliquidated obligation. It demonstrates that the DFAS Columbus Center's reconciliation effort focuses on a greater amount of dollars contained within a relatively small percentage of the total contract population.

Contracts Carrying a Negative Unliquidated Obligation

<u>Dollar Value of Contract</u>		<u>Count</u>	<u>NULO Dollars</u>	<u>Percent Of Count</u>	<u>Percent of Dollars</u>
<u>Greater Than</u>	<u>Equal To Or Less Than</u>				
0	171,000	1,708	20,962,000	93	9
171,000	510,000	71	21,075,000	4	9
510,000	1,171,000	28	20,651,000	1	9
1,171,000	2,083,000	14	20,322,000	1	8
\$2,083,000	\$26,505,000	21	\$11,520,000	1	65%
Total		1,842	\$238,213,000	100	100

Also, the system change request, that was recommended in Recommendation A.2 to improve and monitor the payment process, has been written and funded as a priority. The programming work began in March 1996, with an estimated implementation date of October 1996. A revised Desk Procedure 401, as recommended in Recommendation A.1, was issued on February 7, 1996. The Desk Procedure is a working document clearly stating that under no circumstance will a disbursement transaction be forced through MOCAS, thereby creating a contract level negative unliquidated obligation. Furthermore, as far back as December 1994, the DFAS Columbus Center issued an instruction letter clearly stating payments were not to be paid that created a negative unliquidated obligation at the contract level.

That portion of the finding that states: "Not reducing the number of overdisbursed contracts increased the risk of overpayments to contractors..." is believed to be inaccurate because it leads the reader [incorrectly] to a conclusion that a cause and effect relationship exists. The finding statement is analogous to saying that if several of your friends have overpaid against their personal accounts, you are likely to overpay against your account. There is no evidence that a cause and effect relationship exists to demonstrate that the size of the pool of contracts carrying a negative unliquidated obligation is the root cause of overpayments to other new or existing

contracts. Payments made against new and existing contracts are made according to their individual contract clauses and the unliquidated obligation balances.

Finding B. Reducing the Backlog of Unreconciled Contracts: Although the DFAS Columbus Center made significant progress, it did not achieve the Deputy Secretary of Defense's goal of reducing 3,839 of its most pressing unreconciled problem contracts to 960 (75 percent less) by the end of calendar year 1995. The number of unreconciled contracts as of December 31, 1995, was 1,739 (55 percent less). Additionally the Defense Finance and Accounting Service - Columbus Center did not include 12,688 other out-of-balance contracts in its plan to reduce its backlog of unreconciled contracts. These conditions occurred because the DFAS Columbus Center:

- ◊ received a higher inflow of contracts in urgent need of reconciliation than projected,
- ◊ did not process reconciliations as quickly as expected, and
- ◊ concentrated resources on reconciling contracts that presented an immediate risk of overpayment, without evaluating and prioritizing the remaining unreconciled contracts.

The continued high level of unreconciled contracts will adversely affect the timeliness of DoD payments to contractors.

OUSDC Response: Partially Concur. The DFAS Columbus Center did receive a higher, than projected, inflow of contracts in urgent need of reconciliation. The inflow increased the contract reconciliation baseline significantly. Between October 1, 1994 and April 30, 1995, the reconciliation baseline increased by 23 percent. Although over half the fiscal year was completed when the additional workload was accepted, the DFAS Columbus Center still achieved a 69 percent reduction against the total FY 1995 contract reconciliation baseline.

This office does not agree that the remaining 12,688 contracts with out-of-balance conditions should be classified as needing a full contract reconciliation. As previously stated, contract reconciliations and contract reviews are significantly different in scope and magnitude. Although the goal of both is to correct contract discrepancies, the time and effort needed are significantly different and their management measurements should not be combined. Although the 12,688 contracts are candidates for contract review, the cost to perform complete contract reconciliations on the 12,688 is not justified.

This office also takes exception to the conclusions stated in the summary to Finding B. Specifically, this office does not agree with the report's wording "the DFAS-Columbus Center decision not to identify all contracts in need of reconciliation as part of its reconciliation goal and to adequately research and identify the priority of those contracts that should be reconciled cloaks the effort ..." The statement could be interpreted to imply that there was a deliberate attempt to distort the numbers or deceive the Headquarters. The DFAS-Columbus Center always has

reported both the reconciliation backlog and the amount of contracts needing review. The conclusion continues with--"Also, other contracts were categorized as review contracts and were not being prioritized and reported." This statement is not true. Contracts needing review are constantly analyzed and prioritized based upon the complexity of completion coupled with the relative monetary risk to the government. Further, as stated above, the DFAS-Columbus Center reports the status of both contracts needing review and those needing reconciliation.

RECOMMENDATIONS

RECOMMENDATION A1: We recommend that the Director Defense Finance and Accounting Service-Columbus Center immediately reissue the interim policy first published in December 1994 that prohibits creation of overdisbursed contracts, and expedite action to incorporate the guidance into Desk Procedure No. 401, Contract Entitlements.

OUSDC RESPONSE: Partially Concur. A revised Desk Procedure 401 was issued February 7, 1996. The Desk Procedure is a working document clearly stating that under no circumstance will a disbursement transaction be forced through MOCAS, thereby creating a contract level negative unliquidated obligation in MOCAS. However, there is no need to reissue the December 1994 policy because the policy, clearly stating that payments that creating a negative unliquidated obligation at the contract level were not to be paid, previously was issued by the DFAS Columbus Center and remains in effect.

Estimated Completion Date: Complete

RECOMMENDATION A2: We recommend that the Director, Defense Finance and Accounting Service-Columbus Center expedite the completion and processing of a system change request that would build the internal controls into the Mechanization of Contract Administration Services system that provides for systematic validation of fund availability, at the contract level, prior to disbursement of the funds.

OUSDC RESPONSE: Concur. The recommended system change request has been written and funded as a priority. The programming work began in March 1996, with an estimated implementation date of October 1996.

Estimated Completion Date: October 1996

RECOMMENDATION B1: We recommend that the Director, Defense Finance and Accounting Service-Columbus Center analyze, prioritize, and include all contracts that contain overdisbursed or otherwise out of balance accounts in the plan for performing contract reconciliations.

OUSDC RESPONSE: Nonconcur. The concept of analyzing and prioritizing contracts that have been identified as candidates for reconciliation is sound. However, not all contracts that contain overdisbursed or otherwise out-of-balance accounts should automatically be scheduled for

a complete contract reconciliation. Although such contracts should receive a contract review, a full contract reconciliation would be unnecessarily costly and time consuming.

RECOMMENDATION B2: We recommend that the Under Secretary of Defense (Comptroller) establish a revised goal for reducing the backlog of unreconciled contracts to 6 months of backlogged workload by the end of FY 1997, and develop a plan for reaching the goal using information collected by DFAS-Columbus Center on the scope of work involved.

RESPONSE: Partially Concur. A new reconciliation workload goal will be established. However, the goal will be established at no more than the normal 60-day on-hand pipeline of inflowing contracts for reconciliation. This goal should be achieved by the end of FY 1997. In addition, the number of contracts needing review should be reduced. DFAS Headquarters and the DFAS Columbus Center are working to establish a feasible goal and milestone plan to address the larger universe of contract review actions. The contract review goal and plan will be established within 90 days.

Audit Team Members

This report was prepared by the Finance and Accounting Directorate, Office of the Assistant Inspector General for Auditing, Department of Defense.

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